## REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE ALBERT LUTHULI LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying financial statements of the Albert Luthuli Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages [xx] to [xx].

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.

4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009.* Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

7. I was unable to obtain sufficient and appropriate audit evidence to confirm the accuracy, classification and completeness of the depreciation expense, amounting to R18 714 542, as disclosed in note 6 to the financial statements, due to limitations placed on the scope of my audit work by the municipality.

8. I was unable to obtain sufficient and appropriate audit evidence to confirm the occurrence, accuracy and completeness of capital under construction transactions, amounting to R1 151 401, included in capital under construction of R30 271 443 in note 6 to the financial statements, due to limitations placed on the scope of my audit work by the municipality.

9. In terms of paragraph 25 of GRAP 17 *Property, Plant and Equipment*, the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. A provision for landfill sites was not raised by the municipality during the year under review as required. It was impracticable to quantify the effect of the misstatement, as no reporting information was available to determine the amount.

10. As the municipality's records did not permit the application of alternative audit procedures, I could not obtain sufficient appropriate audit evidence as to the valuation, existence, rights and completeness of the closing balance of property, plant and equipment as at 30 June 2010 to the amount of R503 837 340, as disclosed in note 6 to the financial statements.

### Leases

11. Paragraph 67 of GRAP13 *Leases,* requires the following disclosure as a minimum: total future operating lease payments should be split into the following categories: not later than one year, later than one year and not later than five years, and later than five years. The municipality did not make this disclosure in the financial statements.

### Receivables

12. The municipality's financial statements did not contain all the required disclosure requirements required by IFRS 7 *Financial Instruments: Disclosures.*

13. In terms of paragraph 79 of GRAP 1 *Presentation of the Financial Statements,* trade and other receivables should be split between trade and other receivables from exchange and non-exchange transactions on the face of the financial statements. The municipality did not make this split in the financial statements. I could not determine the possible effect the impact of the non-compliance with the statement of GRAP might have on the financial statements.

**Revenue**

14. A reconciliation of the distribution loss for both electricity and water sales was not performed on a monthly basis. I could not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of water and electricity sales of R12 445 740, included in total revenue of R226 551 803 as disclosed in the statement of financial performance. No alternative audit procedures could be performed to confirm the completeness of these income balances.

**Reserves**

15. The financial statements did not contain an accounting policy for reserves as required by GRAP 1 *Presentation of the Financial Statements.*

16. GRAP 1 *Presentation of the Financial Statements* states that where comparative information was amended, the appropriate disclosure should be made. Government grants of R24 851 697 were incorrectly included in the statement of changes in net assets for the period ended 30 June 2010. Should this have been correctly accounted for, the closing balance for accumulated surplus / (deficit) reserve for the period ended 30 June 2009 would have increased by R24 851 697.

17. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA Standards of GRAP and in the manner required by the MFMA. The opening balance of "Total" reserves as at 30 June 2008 amounted to R302 972 800. As per the signed financial statements for the year ended 30 June 2009, the opening balance amounted to R297 759 010, resulting in a variance of R5 213 790.

**Creditors**

18. I was unable to obtain sufficient and appropriate supporting information and explanations to confirm the existence, completeness and valuation of trade creditors, amounting to R1 411 916, included in trade payables of R16 372 313 in note 7 to the financial statements, due to limitations placed on the scope of my work by the municipality. The municipality's records did not permit the application of alternative audit procedures regarding these transactions.

19. I was unable to obtain sufficient and appropriate audit evidence to confirm the occurrence and accuracy of the retentions, amounting to R1 915 661, included in retentions of R4 547 163 as disclosed in note 7 to the financial statements, due to limitations placed on the scope of my work by the municipality. The municipality's records did not permit the application of alternative audit procedures regarding these retentions.

**Commitments**

20. GRAP 1 *Presentation of the Financial Statements* states that financial statements must be fairly presented. Capital expenditure for the year ended 30 June 2010 of R30 176 034 and for the year ended 30 June 2009 of R25 004 198 was incorrectly disclosed as commitments in the financial statements.

21. I was unable to obtain the detailed listing of all commitments applicable to the municipality to confirm the existence and completeness of commitments, due to limitations placed on the scope of my work by the municipality. The entity's records did not permit the application of alternative audit procedures regarding the commitments. I could not determine the possible effect this limitation might have on the financial statements.

**Employee costs**

22. I was unable to obtain supporting information and explanations to confirm the occurrence, accuracy and completeness of employee-related costs, amounting to R62 566 937, as disclosed in note 22 to the financial statements, due to limitations placed on the scope of my work by the municipality. The municipality was struck by lightning and lost all the VIP records, and due to a lack of proper backup procedures, no alternative procedures could be performed on employee expenses.

23. I was unable to obtain supporting information and explanations to confirm the occurrence, accuracy and completeness of councillors' remuneration, amounting to R9 006 912, as disclosed in note 23 to the financial statements, due to limitations placed on the scope of my work by the municipality. The municipality was struck by lightning and lost all the VIP records, and due to a lack of proper backup procedures, no alternative procedures could be performed on councillors' remuneration.

**Qualified opinion**

24. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Albert Luthuli Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in all material respects, in accordance with SA Standards of GRAP and in the manner required by the MFMA.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

25. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA and the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), and financial management (internal control).

**Predetermined objectives**

26. Material findings on the report on predetermined objectives as set out on pages [XX] to [XX] are reported below:

***Non-compliance with regulatory and reporting requirements***

***Non-compliance with regulatory requirements***

27. The performance report was not submitted with the financial statements to the Auditor-General, as required by section 126 of the MFMA.

***Changes to planned performance not disclosed in annual performance report***

28. Changes to the targets from the approved integrated development plan and the SDBIP for the year under review were not disclosed and explained, as required in terms of the relevant National Treasury preparation guide.

***Inadequate content of integrated development plan***

29. The integrated development plan of the municipality did not include the input, output and outcome indicators determined in terms of the performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

***Incomplete reporting on all predetermined objectives, indicators and targets***

30. The actual achievements with regard to 33% of all planned indicators and targets specified in the integrated development plan and the SDBIP for the year under review for the selected departments were not reported in the annual performance report submitted for audit purposes.

***Planned and reported performance targets not specific, measurable and well defined***

31. For the selected departments, 25% of the planned and reported targets were not:

- specific in clearly identifying the nature and the required level of performance
- measurable in identifying the required performance
- well defined with an unambiguous definition to allow for data to be collected consistently.

***Reported indicators and targets not valid as inadequate supporting source information was provided***

32. For the selected departments, the validity and accuracy of 71% of the reported targets could not be established, as sufficient appropriate audit evidence could not be provided for audit purposes.

***Reported information not consistent with planned objectives, indicators and targets***

33. The municipality did not report on its performance against predetermined objectives, indicators and targets, which were consistent with the approved integrated development plan and the SDBIP.

**Compliance with laws and regulations**

**Municipal Finance Management Act**

**Accounting officer did not adhere to his statutory responsibilities**

34. Contrary to sections 61-70 and 93-100 of the MFMA, the accounting officer did not adhere to his legislative responsibility of managing the financial administration of the municipality by taking reasonable steps to ensure the following:
    a. Full and proper records of the financial affairs of the municipality were kept in accordance with any prescribed norms and standards.
    b. The municipality had and maintained effective, efficient and transparent systems of financial and risk management.
    c. The municipality has effective revenue collection systems consistent with section 95 of the MSA and the municipality's credit control and debt collection policy.

### Expenditure was not paid within the set parameters

35. Expenditure amounting to R5 062 004 was not paid within the required 30 days from the receipt of an invoice, as prescribed by section 65(2)(e) of the MFMA.

### Financial statements not submitted in time to the Auditor-General as prescribed by the MFMA

36. The municipality did not submit its financial statements within two months after the end of the financial year to the Auditor-General for auditing, as prescribed by section 126 of the MFMA. The financial statements were only submitted on 1 March 2011.

## INTERNAL CONTROL

37. I considered internal control relevant to my audit of the financial statements, the report on predetermined objectives and compliance with the MFMA and the MSA, but not for the purposes of expressing an opinion on the effectiveness of internal control.

38. The matters reported below are limited to the significant deficiencies regarding the basis for the qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

### Leadership

39. The accounting officer did not exercise oversight responsibility over reporting and compliance with laws and regulations as well as internal control and key officials were not available throughout the audit process.

40. The municipality did not take actions to address the risk relating to the achievement of complete and accurate financial and performance reporting. The municipality also failed to address internal and external audit findings.

### Financial and performance management

41. The municipality did not have competent individuals who understood the financial reporting framework and performance management requirements, resulting in financial statements and the performance report not being submitted on time. Furthermore, the annual financial statements and performance information were subject to material amendments resulting from the audit.

42. The municipality failed to submit requested information without any significant delay.

### Governance

43. The municipality did not identify risks relating to the achievement of financial and performance reporting objectives. The fraud prevention plan of the municipality was also not documented and used as per the requirements of the applicable legislation. Internal controls were not selected and developed to prevent or detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

44. The audit committee did not review the financial statements and performance reports prior to submission to the auditors.

## OTHER REPORTS

45. No other reports were issued.

Auditor-General

Nelspruit

30 June 2011

AUDITOR-GENERAL
SOUTH AFRICA

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